Do you really need a DFM: 6 critical questions

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Summary

Financial advisors are increasingly outsourcing the investment management function of their client portfolios to Discretionary Fund Managers (DFM's). However, every financial practice is unique and every advisor should carefully consider six critical questions before making the choice to partner with a DFM. The six questions include areas such as having the requisite licence and experience, being satisfied with investment and operational processes, having enough time to service existing clients and build new relationships, obtaining access to cost-effective investment products and ensuring clients are invested in appropriate risk-profiled solutions.

Introduction

Financial advisors are increasingly outsourcing the investment management function of their client portfolios to Discretionary Fund Managers (DFM's). Some of the reasons cited include the Retail Distribution Review (RDR) legislation that places the onus on financial advisors to make informed investment decisions; as well as the perceived value that DFM's add to advisor practices and increased rigour to their investment processes.

Just because an increasing number of advisors are partnering with DFM's, does it follow that your unique practice will also benefit from the services of a DFM?

We would argue that every financial practice is unique and every advisor should carefully consider the following six critical questions before making the choice to partner with a DFM:

- Do you have your own CAT II licence and experience of managing your own model portfolios across LISP platforms?
- Are you satisfied with your investment process?
- Are you comfortable with your operational process?
- Do you have enough time to service your current clients and build new client relationships?
- Do you have access to cost-effective investment products?
- Do you provide appropriate investment options to your clients?

In the following sections we will explore these questions in more detail.

Q1: Do you have your own CAT II licence and experience of managing your own model portfolios across LISP platforms?

If you do have a CAT II license and have a discretionary mandate from your clients to manage their investments in a model portfolio or other appropriate investment vehicle, you may be very comfortable in managing these portfolios without the insight of a DFM.

However, not all financial advisors want to go through the process of applying for a Category II – Discretionary FSP licence, and some advisors may be unable to demonstrate that they have the required qualifications and experience regarding the financial services and the financial products in respect of which authorisation is being sought from the FSCA.

If you do not currently have a CAT II licence or if you are not interested in obtaining a CAT II licence in the future, you may want to partner with a DFM that will manage your clients' funds on your behalf in a model portfolio on one or more LISP platforms. Any changes to the model portfolio will be implemented by a single instruction, and all clients in the model portfolio will be rebalanced effortlessly to the new model portfolio.

Q2: Are you satisfied with your investment process?

Your investment process should ideally cater for the following:

- Access to timely economic information and research to inform strategic and tactical asset allocation decisions.
- Fund manager research is performed based on both qualitative and quantitative characteristics and includes research on passive, smart beta and active (established and boutique) fund management strategies.
- Portfolio construction incorporates the latest methodologies and ensures optimal blending of uncorrelated fund managers.
- Regular reviews of the above take place to evaluate and calibrate the overall portfolio performance relative to the initial portfolio design objectives.
- Access to world-class decision-support systems such as Bloomberg, FactSet and Morningstar Direct.

If you are lacking in some or all of the above investment process components, it may be time to engage with a short-list of potential DFM candidates.

Q3: Are you comfortable with your operational process?

The investment and operational processes are joined at the hip; and they should complement each other. Are you satisfied that:

- Your portfolios are FAIS compliant.
- You have a dedicated team of operational staff who works closely with the LISP platforms.
- All trades and switches are performed accurately and efficiently.
- You have transparency regarding pricing, see-through asset allocation, holdings and manager concentration.
- Monthly fund fact sheets are produced and provided in a timely manner.

Ensure you ask your short-list of DFM candidates regarding their operational process.

Q4: Do you have enough time to service your current clients and build new client relationships?

As a financial advisor your time is limited and precious. Have you performed an audit on how your typical day is structured, and how many of those activities are geared towards the following value-adding tasks:

- Building new client relationships.
- Nurturing existing client relationships.
- Spending enough time with new and current clients to fully understand their needs and aspirations, and then designing financial plans with a high probability of achieving your clients' goals and objectives.
- Providing excellent client service; thus paving the road to referrals from satisfied clients.

If you find that most of your time is spent on researching investment ideas, performing due diligences on investment managers, constructing and monitoring investment portfolios – it may be time to partner with a DFM to free up your time to focus on what matters most to your clients and your business.

Q5: Do you have access to cost-effective investment products?

Some DFM's have unique and cost-effective investment products that are offered to their clients only. An example may be where the DFM has approached one or two investment managers, negotiated attractive fees for managing segregated portfolios on behalf of the DFM, and these segregated portfolios are then wrapped in a unique and attractively-priced collective investment scheme. These cost-effective products are then offered to be used in some of the model portfolios constructed for clients of the financial advisor. The advisor should never be forced to use these products, and the use of these products should be encouraged only if it makes sense from a return, risk and cost perspective.

Q6: Do you provide appropriate investment options to your clients?

Have you segmented your client base and decided on the optimal number of risk-profiled portfolio solutions to offer your client base? Have you ensured that each fund per risk-profiled solution has a specific role to play and that the overall portfolio construction will enable you to meet or exceed your investment target over the appropriate time period? Are you monitoring the performance and risk characteristics of these risk-profiled solutions diligently and do you have a risk management strategy to ensure the portfolios stay on course through different market environments?

If not, enquire from your short-list of DFM candidates how they could support you in providing appropriate risk-profiled solutions to your clients.

In Summary

If you have considered the six critical questions thoughtfully and concluded that you:

- Have your own CAT II licence and enough experience in managing your own model portfolios;
- Are satisfied with your investment process;
- Are comfortable with your operational process;
- Have enough time to service your current clients and build new client relationships;
- Have access to cost-effective investment products and
- Provide appropriate investment options to your clients.

Then you don’t need to engage with a DFM…

However, if you’ve considered the six critical questions and have a nagging feeling that you may need some help in some area, let us know at dfm@analytics.co.za.

As an advisor, you have spent a lot of time and effort in building your reputation. At Analytics , we will do our utmost to protect, enhance and further build your reputation. With over 15 years of experience working with advisors, we are well-known for providing consistent performance and excellent client service. By removing the day-to-day management of your clients’ investments, you will be able to concentrate on the one critical issue that built your reputation in the first place - offering the best advice and service to your clients.

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Daniel is currently CIO of the Analytics multi-manager funds of funds. He has more than 19 years investment and portfolio management experience, and has previously worked at three of the largest multi-managers in South Africa, first at Investment Solutions, then joined Momentum MultiManagers which later merged with MCubed to form Advantage Asset Managers, His main responsibilities include economic research, tactical asset allocation, investment manager research, portfolio construction, monitoring and risk management, system development and innovative investment research, He is also a member of the Investment Committees of some of the largest advisor networks in South Africa, providing investment consulting services to these groups on an on-going basis.